(1)

83-1961

No. 83-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

LANDRETH TIMBER COMPANY,
Petitioner,

v.

IVAN K. LANDRETH, LUCILLE LANDRETH,
THOMAS E. LANDRETH, IVAN K. LANDRETH, JR.,
AND KATHLEEN LANDRETH,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

Whether the purchase of all the common stock of a traditional business corporation is a transaction in "securities" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Landreth Timber Company petitions that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on March 7, 1984.

OPINIONS BELOW

The original opinion of the United States Court of Appeals rendered on March 7, 1984, is not yet officially reported; it is unofficially reported at [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,705 (9th Cir. 1984). A copy of that opinion is attached as Appendix A. On April 24, 1984 one paragraph of that opinion was modified. A copy of the modifying order is attached as Appendix B. The unreported order and judgment of the United States District Court for the Western District of Washington is attached as Appendix C.

JURISDICTION

The judgment of the United States Court of Appeals was entered on March 7, 1984. Jurisdiction to review that judgment by writ of *certiorari* exists pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statutes principally involved in the opinion and order of the United States Court of Appeals and in this petition are the definitional sections of the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* The relevant portions of the definitional sections of those Acts, 15 U.S.C. §§ 77b(1) and 78c(a)(10), are reproduced in Appendix D.

STATEMENT OF THE CASE

Prior to November 16, 1977, Ivan K. Landreth and his two sons[1] were the sole shareholders of Landreth Timber Company ("Landreth Timber"), which owned a sawmill in Tonasket, Washington. Ivan Landreth and his sons had earlier decided to sell their interests in Landreth Timber, but, before a buyer could be found, a portion of its sawmill burned. After the mill had been rebuilt partially, the Landreths succeeded in interesting a small group of investors in purchasing Landreth Timber.[2] The principal members of the investing group were Samuel S. Dennis, 3d, then a 67-year-old Boston attorney, and the late John Bolten, then an 84-year-old businessman who had retired in Florida. Neither Mr. Dennis nor Mr. Bolten had any experience in or knowledge of the lumber

[1] Mr. Landreth's wife and the wife of his son Ivan K. Landreth, Jr., were named as defendants because the proceeds of the sales by Messrs. Landreth inured to the benefit of the marital community composed of them and their wives.

[2] Although the Landreths now seek to avoid the application of the federal securities laws, they insisted from the outset that this transaction be structured as a sale of stock.

industry. Accordingly, their agreement to purchase the company was contingent on Ivan K. Landreth's agreement to assist in the company's management as a paid consultant.

A series of negotiations resulted in a detailed stock purchase agreement, with Mr. Dennis the purchaser, and Mr. Landreth and his sons the sellers, of Landreth Timber's common stock. Mr. Dennis' rights were assigned to a Delaware corporation, named B & D Company after Messrs. Bolten and Dennis, which had been formed for the sole purpose of acquiring Landreth Timber's common stock. After B & D Company became the owner of Landreth Timber's stock, it merged with Landreth Timber. The result of that merger was a Delaware corporation which bore the name of the original corporation, Landreth Timber Company.

Because neither Mr. Dennis nor Mr. Bolten were experienced in the lumber industry, their decision to purchase Landreth Timber's stock, and their valuation of it were necessarily, and importantly, influenced by their reliance upon information provided, and representations made, by Mr. Landreth. Mr. Landreth made representations concerning, for example, the cost of the mill's reconstruction, the ability to operate the existing machinery, and the productive capacity of the mill when fully rebuilt. Those representations were materially false. The actual cost of rebuilding the mill was substantially more than represented, and much of the machinery which Mr. Landreth represented and warranted to be operable was not. Even after the more expensive rebuilding process was completed and the inoperable machinery was replaced, the productive capacity of the mill was significantly below Mr. Landreth's representations. Accordingly, the mill could not be operated profitably. The mill was then sold, and Landreth Timber Company went into receivership.

Landreth Timber Company, the corporation which resulted from the merger of B & D Company and Landreth Timber, sued within one year of the stock transaction. Landreth Timber Company sought damages of $2,500,000 for violations of the federal securities laws.[3] The defendants moved for summary judgment, basing their motion solely on the argument that, because the petitioner had purchased 100 percent of the stock of Landreth Timber, it had not purchased a "security."

The District Court granted the motion for summary judgment. Although the court found that the common stock purchased "possessed the ordinary characteristics of stock," it held that the common stock was not a "security" because 100 percent of the shares had been transferred. On appeal, the United States Court of Appeals for the Ninth Circuit affirmed. Recognizing that the issue "whether the sale of 100 percent of the stock of a closely-held corporation is a transaction involving a 'security' has divided courts and commentators," and was a question of first impression in the Ninth Circuit, App. A 5a-6a, the Court of Appeals held that the stock was not a "security." App. A 9a. The Court of Appeals concluded that earlier decisions in which it had adopted the so-called "risk capital" test to determine whether a note was a "security," required that it focus on the transaction rather than the instrument. App. A 8a-9a. Applying its analysis, the Court of Appeals held that the transaction was a "sale-of-business" rather than "a contribution of risk capital

[3] The common stock of the original Landreth Timber had been acquired for $3,953,095. In its complaint, petitioner alleged violations of Sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(2) and 77q(a) and Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b). Landreth Timber Company also raised, as pendent claims, claims under the laws of the State of Washington. Those claims were dismissed for lack of jurisdiction upon the dismissal of the federal securities law claims to which they were appended.

subject to the entrepreneurial or managerial efforts of others," App. A 7a,[4] and held the federal securities laws inapplicable.

REASONS FOR GRANTING THE WRIT

I. The Recent Grant of *Certiorari* in *Seagrave Corp. v. Vista Resources, Inc.* Requires That the Issue Presented By This Petition Be Determined By This Court.

On May 14, 1984, *certiorari* was granted in *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227 (2d Cir. 1982), *modified*, 710 F.2d 95 (1983) (per curiam) (terminating previously retained jurisdiction and remanding for trial), *cert. granted*, 52 U.S.L.W. 3185 (1984) (hereinafter "*Seagrave*"). *Seagrave* presents the identical issue of law presented here: whether the sale of all of the stock of a business corporation involves the sale of a "security" for the purposes of the federal securities laws. As more fully described in the next section, and as the Court of Appeals recognized in its opinion, that issue is one which has divided courts and commentators. Further, as reflected in the Solicitor General's *amicus curiae* brief in *Seagrave*, this issue is one which the Securities and Exchange Commission believes to have an important influence upon the federal securities laws.

In addition to the above interests, two additional reasons support the grant of this petition. First, unless the present petition is granted, petitioner will be denied the opportunity to have its rights determined on the basis of this court's ultimate decision in *Seagrave*. The *Seagrave* decision will establish a uniform rule for the Courts of Appeals, which are divided on the issue presented in this case. It would be unjust for the petitioner's case to be decided by any rule other than the rule to be declared by this Court.

[4] The Court of Appeals quoted from Great Western Bank & Trust v. Kotz, 532, F.2d 1252, 1257 (9th Cir. 1976) (citing El Khadem v. Equity Securities Corp., 494 F.2d 1224, 1229 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974)).

Second, the present petition offers the Court an opportunity to consider, in resolving this issue, a factual pattern distinct from *Seagrave*. In *Seagrave*, the purchasers were sophisticated businessmen acquiring the shares of a company publicly traded on the New York Stock Exchange. In contrast, the investors in Landreth Timber did not, as the Court of Appeals noted, have "any knowledge of the lumber industry." App. A 2a. Moreover, in contrast to the substantial information concerning publicly traded companies available in *Seagrave*, in appraising the value of Landreth Timber's common stock, the purchasers were required to rely upon representations made by Mr. Landreth, and upon any investigation the purchasers could conduct. Finally, because neither Mr. Dennis nor the late Mr. Bolten were of an age or background which made it practical for them to manage a lumber mill located a continent away, the factual context of their transaction provides a counterpoint to the acquisition in *Seagrave*, where the acquired company was to be folded into a company operated by the purchasers.

The petition for *certiorari* should, therefore, be granted. In addition to the importance of the issue to be resolved in *Seagrave*, the present petition should be granted to afford fair treatment to the petitioner by insuring that its rights are determined by the standard set by this Court's *Seagrave* decision, and to provide another factual context in which to consider the solution it proposes for this difficult issue [5] on which the circuits are divided.

II. The Decision of the Ninth Circuit Court of Appeals Conflicts With Prior Decisions of Other Federal Courts of Appeals.

The Ninth Circuit's decision is squarely at odds with the rulings of three Courts of Appeals, and with the apparent conclusion of two others. In addition to the Ninth Circuit's recent resolution of the question, eight other

[5] Petitioner has filed at the same time as this petition a Motion for Expedited Consideration and Consolidation For Argument with *Seagrave*.

Courts of Appeals have addressed this issue. The Seventh,[6] Tenth,[7] and Eleventh [8] Circuits, like the Ninth Circuit, have adopted the "sale-of-business" doctrine. Three others, the Second,[9] Fourth,[10] and Fifth [11] Circuits have expressly rejected the doctrine, holding that so long as shares of stock possess the characteristics ordinarily associated with common stock, they are "securities." In addition, the Third [12] and Eighth [13] Circuits have, less directly, rejected the "sale-of-business" doctrine as an exclusion from the coverage of the federal securities laws.

This sharp division between the circuits creates an untenable situation in which questions of venue and personal jurisdiction dictate the availability of federal remedies. A purchaser who can obtain venue in either the Eighth or Ninth Circuit may find that the protection of the federal securities laws is obtained by filing in a District Court in the Eighth Circuit, but forfeited by filing

[6] Sutter v. Groen, 687 F.2d 197, 202 (7th Cir. 1982); Canfield v. Rapp & Son, Inc., 654 F.2d 459, 465 (7th Cir. 1981); Fredericksen v. Poloway, 637 F.2d 1147, 1151-52 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981).

[7] Christy v. Cambron, 710 F.2d 669, 672 (10th Cir. 1983); Chandler v. Kew, Inc., 691 F.2d 443, 444 (10th Cir. 1977).

[8] King v. Winkler, 673 F.2d 342, 345-46 (11th Cir. 1982).

[9] Seagrave Corp. v. Vista Resources, Inc., 696 F.2d 227, 279 (2d Cir. 1982), *modified*, 710 F.2d 95 (1983) (per curiam) (terminating previously retained jurisdiction and remanding for trial), *cert. granted*, 52 U.S.L.W. 3185 (1984); Golden v. Garafalo, 678 F.2d 1139, 1144 (2d Cir. 1982).

[10] Coffin v. Polishing Machines, Inc., 596 F.2d 1202, 1204 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979); Occidental Life Insurance Co. v. Pat Ryan & Associates, Inc., 496 F.2d 1255, 1263 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974).

[11] Daily v. Morgan, 701 F.2d 496 (5th Cir. 1983).

[12] Glick v. Campagna, 613 F.2d 31, 35 n.3 (3d Cir. 1979).

[13] Cole v. PPG Industries, Inc., 680 F.2d 549, 555-56 (8th Cir. 1982).

in a District Court in the Ninth Circuit. That anomaly is heightened by the fact that, given the interstate nature of many securities transactions and the vagaries of the venue provisions, it is entirely plausible that one party to a single transaction may have remedies under the securities laws, while another does not. *See* Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus. Law. 637, 650 (1982).

The potential for inconsistent results is but a portion of the possible mischief worked by the current uncertainty surrounding the "sale-of-business" doctrine. Some of the courts adopting the doctrine have added to the geographic uncertainty of its application by extending a presumption that the rule applies to acquisitions of less than 100 percent of a corporation's outstanding stock, so long as the purchaser acquires a controlling block of shares. *See Sutter v. Groen*, 687 F.2d 197, 203 (7th Cir. 1982). *See also Christy v. Cambron*, 710 F.2d 669, 672 n.1 (10th Cir. 1983); *King v. Winkler*, 673 F.2d 342, 346 (11th Cir. 1982). Thus, for example, a purchaser who acquires 26 percent of the stock of a corporation from one seller, and later acquires 25 percent of that stock from a second seller may find that his first purchase involved a "security," but his second did not.[14]

Indeed, the "sale-of-business" doctrine may allow events which are to occur after the transaction—such as the degree of management control exercised by the purchasers—to influence the availability of the protection of the federal securities laws. Dependence upon such factually laden inquiries precludes any uniformity or predictability of application, with courts analyzing transactions on a case-by-case basis to ascertain whether the complaining party was an entrepreneur purchasing a business, or an investor "investing" in stock.

[14] Moreover, ownership of less than 51 percent of a corporation's stock may, in some circumstances permit "control." Accordingly, it is often difficult to know how much stock is enough to constitute control. *See, e.g.*, Essex Universal Corp. v. Yates, 305 F.2d 572 (2d Cir. 1962).

This Court's grant of *certiorari* in *Seagrave* will produce a decision which replaces the current, checkerboard pattern with a uniform rule applicable in all the Courts of Appeals. The petitioner should be governed by that rule and *certiorari* should be granted to permit it to participate in the appellate process which determines that rule.

III. The Court of Appeals Erred In Applying the "Investment Contract" Test to This Stock Purchase.

In 1933, Congress defined "security" in "broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933). The definitional section of both the Securities Act of 1933, 15 U.S.C. § 77b(1), and the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), as well as later enactments involving securities,[15] all include the term "stock" in the definition of a security.

The starting point for the construction of any statute is the words of the statute itself, *Greyhound Corp. v. Mt. Hood Stages, Inc.*, 437 U.S. 322, 330 (1978) (subsequent history omitted), and this Court has warned against statutory interpretation contrary to explicit statutory language. *United States v. Rutherford*, 442 U.S. 544, 551 (1979). Indeed, this Court long ago declared that "stock" is generally recognized to be a security because financial instruments "such as notes, bonds, and stocks, are pretty

[15] *See* Public Utilities Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.* at § 79b(16); Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq.* at § 80a-2(36); and Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* at 80b-2(18).

much standardized and the name alone carries well settled meaning." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). Moreover, such "[i]nstruments may be included within any of these definitions, as a matter of law, if on their face they answer to the name or description." *Id.* at 351.

However, the Ninth Circuit and other courts adopting the "sale-of-business" doctrine have departed from the plain words of the statute employed by Congress in defining a "security," electing to substitute their view of "economic reality"—a concept originally developed for the exclusive purpose of determining the contours of the ambiguous term "investment contract"—for the words of the statute. That departure from the plain meaning of the statute not only is unwarranted, but also frustrates private expectations and engenders unnecessary uncertainty in the application and administration of the federal securities laws.

Few would suggest that the label chosen for an instrument by its author concludes the inquiry into the applicability of the definitional sections of the federal securities laws. This Court acknowledged as much in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), rejecting the suggestion that transactions "evidenced by the sale of shares called 'stock'" were *automatically* covered by the provisions of the federal securities laws "simply because the statutory definition of a security includes the words 'any . . . stock.'" *Id.* at 848 (footnote omitted). In *Forman*, the instruments in question, "stock" in a cooperative apartment complex, bore no real relationship to the kind of instrument normally comprehended by the term "stock." Faced with such a situation, this Court's use of the *Howey* investment contract analysis to ascertain "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others," *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946), was a recognition that a name

could not transform an interest in a cooperative apartment into a security.

But the Ninth Circuit erred in its extension of the *Forman* approach to this case. *Forman* does not require going behind the name of an instrument in the absence of a showing that securities labelled "stock" are anything "other than what they appear to be." *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202, 1204 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979). Although *Forman* rejected a "literal approach" to the definition of a security, this Court expressly denied that the name of an instrument is irrelevant to deciding whether it qualifies as a "security." Accordingly, *Forman* emphasized that:

> There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of the significant characteristics typically associated with the named instrument.

421 U.S. at 850-51.

While imprecise notions of "investment contract" and "economic reality" may be useful when attempting to categorize instruments which strain to meet the common understanding of the name given to them, the use of these tests is inappropriate when the instrument represents precisely that bundle of legal rights which, in ordinary usage, is signified by its name. Here, the shares of stock, unlike those in *Forman*, have all the significant characteristics typically associated with "stock," are easily recognized as "securities" in the capital market, and, apparently, are "securities" when less than all of them are sold. No persuasive reason exists to conclude that Congress intended to withdraw the protection of the federal securities laws from their purchaser or seller because they were purchased or sold in a single transaction.

IV. Excluding Common Stock of a Business Corporation From the Definition of "Security" Under the "Sale-of-Business" Doctrine Is of Major Importance to the Administration of the Federal Securities Laws.

The proper definition of "security" is, necessarily, fundamental to the federal securities laws. The exclusion from that definition of an entire category of common stock transactions is inconsistent with Congress' intent to provide a uniform code of conduct applicable to transactions in common stock and other securities. In addition, the reasoning behind the holding of these cases portends further uncertainty as to the definition of a "security." Contrary to this Court's instructions in *Forman*, the Ninth Circuit appears to have treated the name of a financial instrument as "wholly irrelevant," *cf. Forman*, 421 U.S. at 850, to its status as a "security." [16] Only by consigning the name and attributes of the instrument to irrelevancy could the Ninth Circuit hold that an instrument having all the attributes of the most frequently encountered "security"—common stock—is not a security. If this approach is accepted, any measure of certainty in the application of the securities laws will be lost.

Indeed, the present issue has been seen by some as affecting issues broader than the question of whether the sale of all of the stock of a business corporation is a transaction in securities. As Professor Louis Loss has suggested, the "sale-of-business" doctrine comes "dangerously close to the heresy of saying that the fraud provisions [of the federal securities laws] do not apply to private transactions." Loss, Fundamentals of Securities Regulation 212 (1983). Whatever arguments may be mustered in favor of this "heresy," its acceptance would overturn nearly four decades of precedent in which courts have presumed that Congress intended to prohibit fraud in private, as well as public, securities transactions. *See*,

[16] *See* text, *supra* p. 11, quoting *Forman*, 421 U.S. at 850-51.

e.g., *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1974).

This Court's grant of *certiorari* in *Seagrave* suggests that the resolution of the important issues directly presented by this case is forthcoming. Accordingly, *certiorari* should be granted in this case to permit the petitioner to be governed by this Court's forthcoming decision, and to participate in the appellate process which will govern its rights.

CONCLUSION

For the reasons discussed above, a writ of *certiorari* should issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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Dated this 31st day of May, 1984.

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 81-3446

LANDRETH TIMBER COMPANY,
Plaintiff-Appellant,

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH, IVAN K. LANDRETH, JR., and KATHLEEN LANDRETH, husband and wife,
Defendants-Appellees.

Decided March 7, 1984

Appeal from the United States District Court for the Western District of Washington.

Before: BROWNING, Chief Judge, TUTTLE * and FARRIS, Circuit Judges

BROWNING, Chief Judge:

The issue raised in this appeal is whether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a "security" within the meaning of the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa, and the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk. The district court held that it was not, relying upon the "sale of business" exemption from the Security Acts. We affirm.

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* Honorable Elbert Parr Tuttle, Senior Judge, United States Court of Appeals for the Eleventh Circuit, sitting by designation.

I.

Defendant Ivan Landreth and his two sons were the sole shareholders of Landreth Timber Co. (Landreth I) which owned a sawmill in Tonasket, Washington. Landreth decided to sell the mill. Before a buyer could be found, a portion of the mill was destroyed by fire. Landreth began to rebuild, adding modern equipment and design innovations to increase production. Before construction was completed, Samuel Dennis, a Boston attorney representing a small group of investors, expressed an interest in purchasing the mill.

Landreth insisted on a sale of the stock of Landreth I rather than a sale of its assets. Negotiations culminated in a detailed stock purchase agreement. The purchasers formed a Delaware corporation, the B & D Company, to make the purchase. B & D completed the purchase according to the terms of the agreement. B & D then merged with Landreth I to form Landreth Timber Co. II.

Landreth declined the purchaser's offer to manage the mill but signed a one-year consulting agreement with Landreth II, terminable at will on 30-days notice. The purchasers hired a full-time manager; Landreth's post-closing role was purely advisory.

Neither Dennis nor Bolten (Dennis's principal partner) or the other investors in the group had any knowledge of the lumber industry. Their decision to purchase the mill was allegedly based on representations by Landreth as to the cost of rebuilding the mill, and its productive capacity when rebuilt.

For a variety of reasons, Landreth II was unprofitable. Landreth underestimated the cost of rebuilding the mill. Much of the machinery Landreth had warranted as operable was not. Appellant completed the rebuilding and replaced the inoperable machinery, but the productive capacity of the completed mill was considerably below Landreth's predictions. Unable to operate the mill profitably, Landreth II sold the mill and went into receivership.

Landreth II brought suit in the Western District of Washington, claiming damages of $2,500,000 for violations of the federal securities laws. The district court granted summary judgment for the Landreths on the ground that the Landreth stock was not a "security" within the meaning of the Acts.

"Stock" is among the instruments listed in the definition of "security" under the Acts,[1] and the district court

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[1] Section 2 of the Securities Act of 1933 states: When used in this subchapter, unless the context otherwise requires—

> (1) The term "security" means any note, *stock*, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commony known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (emphasis added).

Section 3(A)(3) of the 1933 Act exempts

> Any note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 77c(3).

Section 3(a)(10) of the 1934 Act states:

> (a) When used in this chapter, unless the context otherwise requires—
>
> (10) The term "security" means any note, *stock*, treasury stock, bond, debenture, certificate of interest or participa-

acknowledged the Landreth stock had all the usual characteristics of stock. Nonetheless, the court held that under the test announced in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), Landreth stock was not a "security."

Howey held an instrument to be an "investment contract," and thus a "security," if "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301. Although *Howey* did not address a transaction involving stock, the district court held it was required by *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), to apply the *Howey* test "to all cases where the meaning of a 'security' is at issue." The district court held the Landreth stock was not a "security" under *Howey* because by buying 100% of the stock of Landreth I, B & D Company necessarily expected to operate the business and did not expect to obtain "profits from the managerial or entrepreneurial efforts of others."

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tion in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10) (emphasis added).

The definition under the two Acts has been held to be "virtually identical," *Tcherepnin v. Knight*, 389 U.S. 332, 335-36 (1967).

II.

Whether sale of 100 percent of the stock of a closely-held corporation is a transaction involving a "security" has divided the circuits and commentators.[2] The Sev-

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[2] *Compare* Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus. Law. 637 (1982); Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Securities Transaction*, 57 N.Y.U. L. Rev. 225 (1982); Note, *The Security Status of Stock Transfers Incident to the Purchase of a Business: The "Sale of Business" Controversy in the Aftermath of Golden v. Garafalo*, 47 Alb. L. Rev. (1983); Note, *Function Over Form: The Sale of Business Doctrine and the Definition of "Security,"* 63 B.U.L. Rev. 1129 (1983); Note, *The Sale of Business Doctrine: A Decade After Forman*, 49 Brooklyn L. Rev. 1325 (1983); Comment, *Acquisition of Businesses Through Purchase of Corporate Stock: An Argument for Exclusion from Federal Securities Regulation*, 8 Fla. St. U.L. Rev. 295 (1980); Note, *The Sale-of-Business Doctrine*—Golden v. Garafalo, 1983 B.Y.U. L. Rev. 201 (1983); Note, *The Second Circuit Rejects the Sale of Business Doctrine*, 57 Tul. L. Rev. 715 (1983) (all endorsing the sale of business doctrine) *with* Black, *Is Stock a Security? A Criticism of the Sale of Business Doctrine in Securities Fraud Litigation*, 15 U.C.D. L. Rev. 325 (1983); Hazen, *Taking Stock of Stock and the Sale of Closely Held Corporations: When is Stock Not a Security?*, 61 N.C.L. Rev. 393 (1983); Karjala, *Realigning Federal and State Roles in Securities Regulation through the Definition of a Security*, 1982 U. Ill. L. Rev. 413; Prentice & Roszkowski, *The Sale of Business Doctrine: Relief from Securities Regulation or a New Haven for Welshers?*, 44 Ohio St. L.J. 473 (1983); Rapp, *Federal Securities Laws Should Protect Some Purchases of All or Substantially All of a Corporation's Stock*, 32 Case W. Res. 595 (1982); Comment, *A Criticism of the Sale of Business Doctrine*, 71 Calif. L. Rev. 974 (1983); Note, *Repudiating the Sale-of-Business Doctrine*, 83 Colum. L. Rev. 1718 (1983); Note, 61 Wash. U.L.Q. 659 (1983) (repudiating the sale of business doctrine). *See also* Fitzgibbon, *What is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 Minn. L. Rev. 893 (1980); Note, *Recent Ninth Circuits Developments in Securities Law*, 13 Loy. L.A. L. Rev. 985 (1980); Comment, *Securities Regulation: Application of the Federal Securities Laws to the Sale of a Closely Held Corporation*, 22 Washburn L.J. 406 (1983); Note, *Continuing Confusion in the*

enth,[3] Tenth,[4] and Eleventh[5] circuits recognize the "sale of business" doctrine, under which a purchaser of stock who assumes control of a company is not an "investor" expecting profits from the efforts of others under the *Howey* test, and the stock purchased therefore is not a "security" within the meaning of the Acts. The Second,[6] Third,[7] Fourth,[8] Fifth,[9] and Eighth[10] Circuits reject the doctrine, and hold that the federal securities laws apply if the transferred instruments possess the characteristics commonly associated with stock.

A.

Although the precise question is one of first impression in this circuit, appellees argue that we have decided it in

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Definition of a Security: The Sale of a Business Doctrine, Discretionary Trading Accounts, and Oil, Gas, and Mineral Interests, 40 Wash. & Lee L. Rev. 1225, 1280 (1983).

[3] Sutter v. Groen, 687 F.2d 197, 202 (7th Cir. 1982); Canfield v. Rapp & Son, Inc., 654 F.2d 459, 465 (7th Cir. 1981); Frederiksen v. Poloway, 637 F.2d 1147, 1151-52 (7th Cir. 1981).

[4] Christy v. Cambron, 710 F.2d 669, 672 (10th Cir. 1983); Chandler v. Kew, Inc., 691 F.2d 443, 444 (10th Cir. 1977).

[5] King v. Winkler, 673 F.2d 342, 345 (11th Cir. 1982). *See also* Kaye v. Pawnee Const. Co., 680 F.2d 1360, 1366 n.2 (11th Cir. 1982).

[6] Golden v. Garafalo, 678 F.2d 1139, 1144 (2d Cir. 1982); Seagrave Corp. v. Vista Resources, Inc., 696 F.2d 227, 229 (2d Cir. 1982).

[7] Glick v. Campagna, 613 F.2d 31, 35 n.3 (3d Cir. 1979) (court not persuaded Congress intended Acts to apply to small close corporations, but "a literal reading of the statute and governing precedent" indicate the Acts apply).

[8] Coffin v. Polishing Machines, Inc., 596 F.2d 1202, 1204 (4th Cir. 1979); Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc., 496 F.2d 1255, 1261 (4th Cir. 1974).

[9] Daily v. Morgan, 701 F.2d 496 (5th Cir. 1983).

[10] Cole v. PPG Indus., 680 F.2d 549, 555-56 (8th Cir. 1982) (interpreting Arkansas law).

substance in cases dealing with "notes," which, like stock, are instruments well-known in commerce and specifically listed in the statutory definition of a "security."

We have applied a "risk capital" test to determine whether in a particular transaction a note is a "security" under the Acts.[11] Under this test, a note is a "security" if it reflects "a contribution of risk capital subject to the entrepreneurial or managerial efforts of others." *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1257 (9th Cir. 1976), *quoting El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1229 (9th Cir. 1974). The test distinguishes investment transactions, which are covered by the Act, *see United States v. Carman*, 577 F. 2d 556, 563 n. 9 (9th Cir. 1978), from routine commercial transactions, which are not, *see e.g., Great Western Bank*, 532 F.2d at 1257.

The sale-of-business doctrine rests upon the premise that the Acts apply only to investment transactions, and not to commercial or entrepreneurial transactions. *See e.g., Sutter v. Groen*, 687 F.2d at 201. The doctrine derives from *Forman*, in which the Court stated:

> The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

421 U.S. at 849. The court added "Congress intended the application of these statutes to turn on the economic

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[11] *See* Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426 (9th Cir. 1978) ("promissory note" and other instruments); United California Bank v. THC Financial Corp., 557 F.2d 1351 (9th Cir. 1977) ("put" letter and accompanying notes); Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976) (unsecured "demand note"); El Khadem v. Equity Sec. Corp., 494 F.2d 1224 (9th Cir. 1974).

realities underlying a transaction, and not on the name appended thereto." *Id.* The doctrine looks to the *Howey* test to determine whether in "economic reality" the transaction involves an investment. Under *Howey*, as the district court noted, the test is whether "the scheme involves an instrument of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301.

The application of the *Howey* test to the acquisition of a business through purchase of stock is straightforward: when a person purchases control of a business, he does not make an investment from which he expects profits solely from the efforts of others. Although the transaction involves stock, the economic realities reflect acquisition of a business, not passive investment, and the Acts therefore do not apply. Cases that reject the sale-of-business doctrine look only to the nature of the instruments involved: if they possess the ordinary characteristics of stock, they are "securities" and within the coverage of the Acts without regard to the nature of the underlying transaction.

In contrast, both the sale-of-business doctrine and the risk capital test follow *Forman* and reject a literal reading of the statute in favor of an inquiry into the economic realities of the underlying transaction. Both include a transaction only if it involves "an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301. Both exclude essentially "commercial" transactions in which there is no "investment." Thus, risk capital cases and cases endorsing the sale-of-business doctrine interpret the Acts in precisely the same way.

We see no principled way to justify an analysis in which we determine whether a note is a "security" within the meaning of the Acts by examining the transaction in light of the statutory purpose, but determine whether

stock is a "security" by examining only the instrument and not the transaction in light of the statutory purpose. We therefore conclude that adherence to the principle of construction adopted in our "note" cases requires adherence to the "sale-of-business" exclusion from the Securities Acts of the purchase of 100% of the stock of closely-held corporation.

B.

The sale-of-business doctrine is still evolving, and its contours remain in some respects uncertain. However, under any formulation of the doctrine, the economic realities of this transaction leave no doubt that the district court reached the correct result, at least with respect to the sole appellant in this case, Landreth II.

As to Landreth II, the underlying transaction involved the sale of an entire business, effected through a sale of 100% of the corporation's stock. Following the transaction, Landreth II had full control of the corporation, including the day-to-day operations of the mill and its employees. In "economic reality," the underlying transaction was a sale of a lumber business and, under the sale-of-business doctrine, was not an investment in a "security."

Appellant suggests summary judgment was inappropriate because there were disputed issues of fact with regard to Landreth's post-closing managerial role. Appellant asserts it purchased the Landreth stock only because it believed Landreth would supervise the enterprise without participation by members of the purchasing group until the mill was completed and profitable operations were underway. The uncontested facts belie this assertion. Purchasers attempted to convince Landreth to continue as manager of the mill, but he refused. Appellant employed its own manager who assumed effective control of the business. Landreth agreed to serve only as a consultant, and for no more than one year; even these services

were terminable at the will of appellant. Neither Landreth nor appellant's manager can be regarded as a third-party upon whose efforts the purchaser relied for its profit within the meaning of *Howey*. *Bitter v. Hoby's International, Inc.*, 498 F.2d 183, 186 (9th Cir. 1974).

III.

While this appeal was pending Landreth II moved to add as plaintiffs Dennis, and Bolten individually and as the administrator of the estate of his wife, Katharine S.A. Bolten. Although appellant brought this motion under Fed. R. Civ. P. 19 to add parties plaintiff, in substance it is a motion to intervene under Fed. R. Civ. P. 24 since the parties to be added are appellant's controlling stockholders. A court of appeals may permit intervention where none was sought in the district court "only in an exceptional case for imperative reasons," *McKenna v. Pan American Petroleum Corp.*, 303 F.2d 778, 779 (5th Cir. 1962). Intervention is sought without stating any reason for failure to intervene in the district court beyond the fact that intervention would permit the additional parties to avail themselves of the doctrine recognized in *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982), decided after this appeal was filed. Bolten and Dennis were obviously aware of defendants' reliance on the sale-of-business doctrine in the district court. No "imperative reason" has been advanced to allow intervention at this late date. As appellees point out, intervention would raise new issues of fact and law not before the district court. *See Spangler v. Pasadena City Board of Education*, 552 F.2d 1326, 1328 (9th Cir. 1977). The motion is denied.

The judgment is affirmed.

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 81-3446

LANDRETH TIMBER COMPANY,
Plaintiff-Appellant,
v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH, IVAN K. LANDRETH, JR., and KATHLEEN LANDRETH, husband and wife,
Defendants-Appellees.

ORDER

Before: BROWNING, Chief Judge, TUTTLE * and FARRIS, Circuit Judges

The opinion dated March 7, 1984 is modified to delete the entire paragraph beginning: "For a variety of reasons, Landreth II . . .," slip op. at 1311. The following shall be added to the beginning of the following paragraph:

> Landreth II was unprofitable. It sold the mill, and went into receivership.

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* Honorable Elbert Parr Tuttle, Senior Judge, United States Court of Appeals for the Eleventh Circuit, sitting by designation.

APPENDIX C

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

No. C78-663R

LANDRETH TIMBER COMPANY, INC.,
Plaintiff,

v.

IVAN K. LANDRETH and LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH, IVAN K. LANDRETH, JR., and KATHLEEN LANDRETH, husband and wife,
Defendants.

IVAN K. LANDRETH AND LUCILLE LANDRETH, husband and wife; THOMAS E. LANDRETH; IVAN K. LANDRETH, JR. and KATHLEEN LANDRETH, husband and wife,
Counterclaim Plaintiffs,

v.

LANDRETH TIMBER COMPANY, INC.,
Counterclaim Defendant.

ORDER GRANTING SUMMARY JUDGMENT

THIS MATTER comes before the Court on cross-motions for summary judgment. Oral argument was heard on February 27, 1981. At the conclusion of that hearing, the Court indicated its inclination to grant summary judgment in favor of the defendants and asked counsel to submit a list of admitted facts bearing on the issue of

managerial control. Subsequent to the hearing, counsel submitted admitted facts and supplemental memoranda regarding managerial control. Counsel for the plaintiff also filed a motion for reconsideration. On April 17, 1981, the Court heard argument on the issue of managerial control. Having considered the motions, memoranda, affidavits, admitted facts, and being fully advised, the Court now finds and rules as follows:

This is an action by the plaintiff Landreth Timber Company to recover for violations of the federal securities laws,[1] state securities laws and state common law. The issue presented is whether the sale of 100% of the stock of a closely-held corporation is a transaction covered by the federal securities laws. This Court joins a growing majority in holding that the federal securities laws do not apply.

Summary judgment is proper where there is no genuine issue of material fact or where viewing the evidence and the inferences which may be drawn therefrom in the light most favorable to the adverse party, the movant is clearly entitled to prevail as a matter of law. *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252, 1254 (9th Cir. 1976); *Marx v. Computer Services Corp.*, 507 F.2d 485, 487 (9th Cir. 1974). A factual issue is immaterial if resolution of the issue is not necessary in order for the court to reach its decision. *Cordas v. Speciality Restaurants, Inc.*, 470 F. Supp. 780 (D. Ore. 1979).

The material facts in this case are undisputed. The defendants sold 100% of the stock of the Landreth Timber Company to the plaintiff's predecessor-in-interest. The stock possessed the ordinary characteristics of stock.

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[1] Section 12(1), 12(2), and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(1), 77l(2) and 77q(a); section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); Rule 10b-5 of the Securities Exchange Commission, 17 CFR § 250.10b-5.

The two principal financial backers behind the purchase, Samuel S. Dennis and John Bolten Sr., were not knowledgeable in any aspect of the lumber industry.

Prior to closing the transaction, the purchasers retained Phil Cook to be general manager of the mill after closing. On the closing date, November 17, 1977, two agreements were entered into: (1) a stock purchase agreement which transferred 100% of the stock and required the defendants to deliver to the purchasers the signed resignations of all the officers and directors of the Landreth Timber Company, and (2) a consulting agreement between Ivan K. Landreth Sr. and the purchasers. The nature and scope of Landreth's post-closing role as consultant was defined in the consulting agreement as follows:

> 1.2 *Consulting Duties, Etc.* The Company shall employ the consultant (a) to participate in the operation of the timber mill owned by the Company in the first six (6) months of the Consulting Period, and (b) for such purposes as the Company reasonably deems appropriate in the second six (6) months of the Consulting Period; and the consultant shall devote such time and effort and shall perform such services as are appropriate or necessary to the performance of his duties as a consultant to the Company in connection with such participation and for such purposes.

Pursuant to this agreement, Landreth's role was purely advisory; the authority to make any and all managerial decisions was transferred to Phil Cook and, ultimately, to the purchasers. The consulting agreement also provided that Landreth's post-closing employment was terminable by plaintiff at will upon thirty days' prior written notice.

Subsequent to closing the transaction, it allegedly became apparent that numerous misrepresentations had been made by the defendants during the course of negotiations. The plaintiff terminated the consulting agreement with Landreth and filed this action.

The threshold issue in this case is whether the stock involved is a "security." The parties agree that a transaction evidence by the sale of stock is not necessarily a security transaction simply because the statutory definition of a security includes the words "any . . . stock." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1974). Rather, the courts adhere to the principle that "in searching for the meaning and scope of the word "security" in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

What, then, are the relevant "economic realities" that must be examined? How closely should a court examine a stock before determining whether it is a "security"? It is here that the parties differ. The plaintiff contends that the Court should constrain itself to examining the characteristics of the stock itself. The plaintiff points out that Landreth stockholders have the following rights: receiving notice of any shareholders' meeting; electing and removing directors and filling vacancies; receiving certificates representing their ownership interest; transferring shares to a third party; receiving declared dividends; amending by-laws; and all rights granted to shareholders by Washington law. The plaintiff argues that these traditional characteristics of stock would lead a reasonable purchaser to assume that the securities laws would apply and, therefore, the Court should look no further.

The defendants, on the other hand, urge the Court to look beyond the characteristics of stock to the economic realities of the underlying transaction. They contend that the transaction at issue was essentially the sale of a business, through the transfer of stock, and that such a transaction is not within the purview of the federal securities laws.

This issue can be resolved only after a careful reading of the Supreme Court's decision in *Forman*, *supra*. In *Forman*, residents of a cooperative housing project, who had been required to purchase "stock" in the housing cooperative in order to acquire a residential unit, filed an action for fraud under the federal securities laws. The Court held that the shares of stock did not constitute "securities" within the meaning of those laws.

In part "A" of the Forman opinion, the Court rejected the argument that a transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any . . . stock." 421 U.S. at 848. In doing so, the Court emphasized the purposes underlying the federal securities laws.

> The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. 421 U.S. at 849.

The Court concluded that the "stock" before it was not a "security" within the meaning of the federal securities laws. In doing so, the Court relied both on the fact that the shares did not possess the characteristics traditionally associated with stock (e.g. no dividends, no right to pledge or hypothecate, no voting rights), and on the fact that the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit. 421 U.S. at 851.

In part "B" of the opinion, the Court rejected the Court of Appeals' conclusion that a share in the housing

cooperative was an "investment contract" as defined by the Securities Acts, and rejected the plaintiffs' further argument that in any event what they agreed to purchase is "commonly known as a 'security'" within the meaning of those laws. The Court stated:

> In considering these claims we again must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties. We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a 'security'." In either case, the basic test for distinguishing the transaction from other commercial dealings is
>
> > "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Howey*, 328 U.S. at 301.
>
> This test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. 421 U.S. at 852.

Three aspects of the above-quoted passage should be noted in particular. First, the Court states that "we *again* must examine the substance—the economic realities of the transaction. . . ." (emphasis added). This is a further indication that the Court in part "A" was looking to the economic realities of the underlying transaction, and not simply examining the characteristcs of the stock instruments themselves. Second, the Court indicates a distinction between security transactions and "other commercial dealings." As the Court states later in the same paragraph, in a securities transaction the investor is attracted solely by the prospect of a return on his investment. 421 U.S. at 852.

> By contrast, when a purchaser is motivated by a desire to use or consume the item purchased—"to occupy the land or develop it themselves" as the *Howey* Court put it, *ibid.*—the securities laws do not apply. 421 U.S. at 852-53.

Finally, it should be noted that the Court states that the *Howey* test "embodies the essential attributes that run through *all* of the Court's decisions *defining a security.*" (emphasis added). This is a strong indication that the Court intends that the *Howey* test be generally applicable to all cases where the meaning of "security" is at issue, not just cases involving the definition of "investment contract." This conclusion is further supported later in the *Forman* opinion where the Court states:

> What distinguishes a security transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others. . . . 421 U.S. at 858.

For these reasons, this Court concludes: (1) that it must look beyond the characteristics of the stock itself to the economic realities of the underlying transaction, (2) that it must bear in mind a distinction between security transactions and other commercial dealings, and (3) that the *Howey* test focuses on the relevant "economic realities" and is applicable in determining whether a stock transaction is within the purview of the federal securities laws. These conclusions comport with the majority of post-*Forman* decisions. *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir. 1981); *Chandler v. Kew*, Fed Sec. L. Rptr. ¶ 96,966 (10th Cir. 1977); *Bula v. Mansfield*, Fed. Sec. L. Rptr. ¶ 96,964 (D. Col. 1977); *Dueker v. Turner*, Fed. Sec. L. Rptr. ¶ 97,535 (D. Geo. 1979); *Anchor-Darling Industries v. Leonard Suozzo*, No. 79-4085, E.D. Penn, March 16, 1981; *Barsy v. Verin*, No. 79 C 3323, N.D. Ill., February 25, 1981. *But see Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir. 1979); *Titsch Printing, Inc. v. Hastings*, 456 F. Supp. 445 (D. Col. 1978); *Bronstein v. Bronstein*, 407 F. Supp. 925 (E.D. Penn 1976).

In applying the *Howey* test, this Court need only determine whether the third requirement has been met, whether the purchasers were led to expect profits from the managerial or entrepreneurial efforts of others. This determination must be made based on the factual circumstances at the time of the agreement and not on facts occurring subsequent to the agreement. *El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1228 (9th Cir. 1974). It also irrelevant for the purchasers to argue that they relied on Landreth's past efforts to build up the business. As the Seventh Circuit stated in *Emisco Industries v. Pro's Inc.*, 543 F.2d 38 (7th Cir. 1976):

> This only repeats plaintiffs' allegation of reliance upon misrepresentations made during the purchase. The important element for the transaction to constitute an investment is that [the purchaser] relied on the present and future efforts of another to produce profits. 543 F.2d at 41.

Thus, events occurring prior to the agreement are relevant only insofar as they indicate whether the purchasers, as of the date of the agreement, were led to expect profits resulting from the future entrepreneurial or managerial efforts of others.

The purchasers argue that the third requirement of *Howey* has been met because they were led to expect profits from the efforts of Landreth and Cook. In other words, the purchasers argue that Landreth and Cook are "others" for purposes of the third requirements of the *Howey* test.

This argument exalts a literal reading of the *Howey* test over the purposes of the federal securities laws. The fundamental purpose of those laws is to protect those who place their money in the hands of someone over whom they exercise little or no control. Persons or entities who are beyond the control of the purchaser are

"others" within the meaning of *Howey* and *Forman*. Employees, including managers and consultants, are not. *Bitter v. Hoby's International Inc.*, 498 F.2d 183 (9th Cir. 1974). In the words of the Ninth Circuit in *Bitter*:

> For the manager to be a "third party," within the meaning of the *Howey* test, the manager must be outside of the direct and immediate control of the franchise. 498 F.2d at 186.

In the present case, both Landreth and Cook, as employees, were under the direct and immediate control of the purchasers after the sale and, therefore, they are not "others' or "third parties" within the meaning of *Howey* and *Forman*. Because there are no "others" involved in this case, it is not necessary to apply the analysis in *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973).[2]

For these reasons, the motion for reconsideration is DENIED and the defendants' motion for summary judgment is GRANTED.

IT IS SO ORDERED.

The Clerk of this Court is directed to send uncertified copies of this Order to all counsel of record.

DATED at Seattle, Washington, this 29th day of April, 1981.

/s/ Barbara J. Rothstein
United States District Judge

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[2] In *Turner*, the promoter/seller was beyond the control of the purchasers and, therefore, it was an "other" or "third party" within the meaning of *Howey*. This made it necessary to analyze whether the undeniably significant efforts were those of the purchasers or those of the promoter. But, in the present case, Landreth and Cook are not "others" because they were within the control of the purchasers and, therefore, there is no occasion to analyze whether the undeniably significant decisions were made by Landreth, Cook, or the purchasers.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

No. C78-663R

LANDRETH TIMBER COMPANY, INC.,
Plaintiff,

v.

IVAN K. LANDRETH, *et al.*,
Defendants.

JUDGMENT

This matter having come on for consideration before the Court, Honorable Barbara J. Rothstein, presiding, and the issues having been duly considered and a decision having been duly rendered,

IT IS HEREBY ORDERED AND ADJUDGED that the defendants' motion for summary judgment is GRANTED. Plaintiff's motion for reconsideration is DENIED.

DATED this 27th day of May, 1981.

/s/ Deputy Clerk
United States District Court

APPENDIX D

SECURITIES ACT OF 1933

United States Code, Title 15:

"§ 77b. Definitions

When used in this subchapter, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

SECURITIES EXCHANGE ACT OF 1934

United States Code, Title 15:

"§ 78c. Definitions and application

(a) When used in this chapter, unless the context otherwise requires—

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument

commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."